

The Risk Illuminator

A Quarterly publication for our clients by **Lender's Quality Assurance**, a *Critical Edge Group* company

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Dear JP:

Q: Aside from a Certificate of Occupancy, what other documentation should be obtained prior to funding the last draw on a construction loan?

RP, Chicago, IL

A: In addition to the C of O, you may need other permits and/or agency signoffs, depending on the project type & municipality. A title "bring-down" should be reviewed to confirm that no mechanics & material-mans liens have been filed. You should require a Certificate of Substantial Completion" (continued on page 2)

General Contractor JV's Warrant Close Scrutiny

A Joint Venture between professional firms (i.e. Architect & General Contractor) should be avoided by both lenders & owners. These arrangements can compromise the independent oversight function otherwise provided by the Architect during construction. For example, the Architect may not voice opposition as readily to value engineering recommendations and/or change orders that might "cheapen" the project and thus impair collateral value, especially if they share in any realized cost

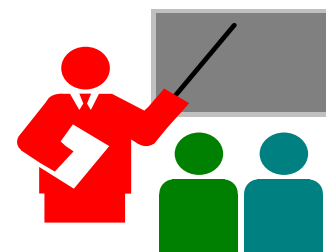
savings pursuant to the Contractor's construction contract. Furthermore, if a contractual dispute arises between the owner and the GC, the Architect will not be in a position to provide an objective opinion on the matter. Finally, the performance bond, if any, should be reviewed closely to confirm that the bonding company expressly recognizes the JV arrangement in conjunction with the bond issuance; otherwise, if issued solely in the construction company's name, the bond may be invalidated if called upon.

Change Order Administration

Once the construction budget has been reviewed & approved, & the "Schedules of Value" have been established, the ONLY appropriate method of moving moneys to, from, or between line items is via a "Change Order" (AIA G701). Requests for Change Orders should be submitted for approval

PRIOR to submission of the applicable payment request. NO Change Order should be implemented until approved by the Owner, the Architect, the Contractor, **and** the Lender's Inspector (LQA) to determine: 1) the physical effect of the change (i.e. cheaper hardware

see page 2 - Chg Orders



Hard-hat

"Master/Slave" Draw Concept

Definition: Special draw administration entailing utilization of more than (1) set of AIA disbursement documents; the "Master" draw includes items which, by themselves, may necessitate the use of a sub or "Slave" set of draw documents.

Certain complex projects, including projects that include provisions for construction of "Tenant Improvements" may necessitate utilization of this concept, especially where

see page 2 - Master/Slave

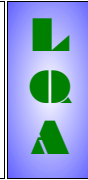
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which should be executed by the owner, architect, and contractor; the final punchlist should also be available and any necessary holdbacks determined. In the event you ever have to take action against your collateral, you should have a set of "As-built" plans, the final specs manual (incorporating all changes), & copies of service, operating, & warranty manuals.

Call **LQA** @
(602) 604-8999

Master/Slave - from page 1

multiple contractors may be involved. This concept allows for an unlimited number of "Slave" documents to be utilized, allowing for complex transactions to be broken down & administered in less complicated pieces. It also makes inspections & determination of percentage of completions more accurate & manageable. Examples of situations where the concept might be especially useful include: 1) for each floor of a multiple story hi-rise building; 2) for Tenant Improvements, including using a separate "Slave" document for each Tenant

Work Letter. This would allow for the owner to utilize different contractors, if necessary or desired, because each "Slave" set of documents would match to a separate contract; 3) for situations where a lender may want to utilize the AIA documents for Total Project Budget Administration - the "Master" would include items not typically found in construction documents; these items may include Land, Developers Fees/Profit, Closing Costs, Interest Reserve, Marketing, etc. In this case the Construction & TI lines would appear as (1) line item each in the "Master".

Chg Orders - from page 1

that could effect user safety or future maintenance, etc.); 2) the effect on the budget - whether or not there is room in the current budget (i.e. from the contingency line item, from other line items, from the owner's pocket, from the contractor's pocket, or some combination, thereof). In some instances the Contractor may be required to provide a copy of the affected portion of the Plans & Specs with the changes clearly marked, thereon. Both ADD & DEDUCT Change Orders should be administered via the Contingency Line item.